

OTTUMWA WATER WORKS
OTTUMWA, IOWA

INDEPENDENT AUDITOR'S REPORT
BASIC FINANCIAL STATEMENTS
AND SUPPLEMENTARY INFORMATION
SCHEDULE OF FINDINGS

DECEMBER 31, 2006

OTTUMWA WATER WORKS

TABLE OF CONTENTS
DECEMBER 31, 2006

	<u>PAGE</u>
<u>OFFICIALS</u>	1
<u>INDEPENDENT AUDITOR'S REPORT</u>	2
<u>MANAGEMENT'S DISCUSSION AND ANALYSIS</u>	3-5
<u>EXHIBIT</u>	
<u>BASIC FINANCIAL STATEMENTS:</u>	
STATEMENT OF NET ASSETS	A 6
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS	B 7
STATEMENT OF CASH FLOWS	C 8
NOTES TO FINANCIAL STATEMENTS	9-15
<u>REQUIRED SUPPLEMENTARY INFORMATION:</u>	
BUDGETARY COMPARISON SCHEDULE OF RECEIPTS, DISBURSEMENTS AND CHANGES IN BALANCES – BUDGET AND ACTUAL	16
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION – BUDGETARY REPORTING	16
<u>OTHER SUPPLEMENTARY INFORMATION:</u>	
DETAIL SCHEDULE OF REVENUES AND EXPENSES	17-18
INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS	19-20
SCHEDULE OF FINDINGS	21

OTTUMWA WATER WORKS

OFFICIALS
DECEMBER 31, 2006

<u>NAME</u>	<u>TITLE</u>	<u>TERM EXPIRES</u>
Teri Messerschmitt	Water Works Trustee	July, 2007
Pete Rich	Water Works Trustee	July, 2008
Clive Parcell	Water Works Trustee	July, 2009
Bruce Turner	Water Works Trustee	July, 2010
Jack Kirk	Water Works Trustee	July, 2012
Richard Wilcox	General Manager	Indefinite
Teresa Peden	Financial Services Manager	Indefinite

INDEPENDENT AUDITOR'S REPORT

Board of Trustees
Ottumwa Water Works
Ottumwa, Iowa

We have audited the accompanying basic financial statements of Ottumwa Water Works as of and for the year ended December 31, 2006. These financial statements are the responsibility of Ottumwa Water Works' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with U.S. generally accepted auditing standards, and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Ottumwa Water Works as of December 31, 2006, and the changes in its financial position and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with Government Auditing Standards, we have also issued our report dated August 16, 2007 on our consideration of the Utility's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations and contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Management's Discussion and Analysis and budgetary comparison information on pages three through five and sixteen are not required parts of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. We did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Utility's basic financial statements. We previously audited, in accordance with the standards referred to in the second paragraph of this report, the financial statements for the two years ended December 31, 2005 (which are not represented herein) and expressed unqualified opinions on those financial statements. The financial statements for the year ended December 31, 2003 (none of which are presented herein) were audited by other auditors, who expressed an unqualified opinion on those financial statements. Other supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

ANDERSON, LARKIN & CO. P.C.

Ottumwa, Iowa
August 16, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

Ottumwa Water Works provides this Management's Discussion and Analysis of its financial statements. This narrative overview and analysis of the financial activities is for the calendar year ended December 31, 2006. We encourage readers to consider this information in conjunction with the Utility's financial statements which follow.

FINANCIAL HIGHLIGHTS

The Utility's operating revenues increased by approximately 5.5% or \$246,570 from 2005 to 2006. Increases in revenue from the sale of hydro electric power accounted for the majority of the increase.

The Utility's operating expenses increased approximately 5.9% or \$222,646 from 2005 to 2006. This increase included a \$192,019 increase in general plant expenses, and a \$69,277 increase in production expenses.

The Utility's net assets increased approximately 4.5% or \$914,717 from 2005 to 2006.

USING THIS ANNUAL REPORT

The Ottumwa Water Works is a publicly owned utility and presents its financial statements using the economic resources measurement focus and the accrual basis of accounting which is the same measurement focus and basis of accounting employed by private sector business enterprises. This discussion and analysis is intended to serve as an introduction to Ottumwa Water Work's basic financial statements. The annual report consists of a series of financial statements and other information as follows:

Management's Discussion and Analysis introduces the basic financial statements and provides an analytical overview of the Utility's financial activities.

The Statement of Net Assets presents information about the Utility's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Utility is improving or deteriorating.

The Statement of Revenues, Expenses and Changes in Net Assets is the basic statement of activities for proprietary funds. This statement presents information on the Utility's operating revenues and expenses, non-operating revenues and expenses and whether the Utility's financial position has improved or deteriorated as a result of the year's activities.

The Statement of Cash Flows presents the change in the Utility's cash and cash equivalents during the year. This information can assist the user of the report in determining how the Utility financed its activities and how it met its cash requirements.

The Notes to Financial Statements provide additional information essential to a full understanding of the data provided in the basic financial statements.

FINANCIAL ANALYSIS OF THE UTILITY

Statement of Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the Utility's financial position. The Utility's net assets as of December 31, 2006 total \$21,057,962. This compares to \$20,143,245 as of December 31, 2005. A summary of the Utility's net assets as of December 31, 2006 and 2005 are presented below.

NET ASSETS

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Current assets	\$ 3,897,960	\$ 4,362,777
Capital assets at cost, less accumulated depreciation	22,600,761	20,059,334
Other assets	<u>37,256</u>	<u>288,628</u>
Total assets	<u>26,535,977</u>	<u>24,710,739</u>
Current liabilities	1,632,721	2,082,736
Long-term liabilities	<u>3,845,294</u>	<u>2,484,758</u>
Total liabilities	<u>5,478,015</u>	<u>4,567,494</u>
Unrestricted assets	2,355,842	2,504,964
Invested in capital assets, net of related debt	18,574,467	17,542,576
Restricted assets	<u>127,653</u>	<u>95,705</u>
Total net assets	<u>\$ 21,057,962</u>	<u>\$ 20,143,245</u>

Statements of Revenues, Expenses and Changes in Net Assets

Operating revenues are received from the sale of water to Ottumwa residents, sale of hydro electric power, and other miscellaneous income. Non-operating revenues and expenses include interest income. The utilization of capital assets is reflected in the financial statements as depreciation, which allocates the cost of an asset over its expected useful life. A summary of revenues, expenses and changes in net assets for the years ending December 31, 2006 and 2005 is presented below:

CHANGES IN NET ASSETS

	<u>Year Ended December 31,</u>	
	<u>2006</u>	<u>2005</u>
Operating revenue:		
Sale of water	\$ 3,486,341	\$ 3,459,473
Sale of electricity	967,574	758,650
Miscellaneous income	<u>272,609</u>	<u>261,831</u>
Total operating revenue	<u>4,726,524</u>	<u>4,479,954</u>
Operating expenses:		
Production	622,345	553,068
Distribution	638,554	653,202
Hydro	142,092	102,628
Financial services	240,873	217,128
Administration	400,254	488,880
General plant	1,162,176	970,158
Depreciation and amortization	<u>769,578</u>	<u>768,162</u>
Total operating expenses	<u>3,975,872</u>	<u>3,753,226</u>
Operating income	750,652	726,728
Nonoperating revenue:		
Interest income	<u>164,065</u>	<u>79,576</u>
Change in net assets	914,717	806,304
Net assets – Beginning of year	<u>20,143,245</u>	<u>19,336,941</u>
Net assets – End of year	<u>\$ 21,057,962</u>	<u>\$ 20,143,245</u>

The Statement of Revenues, Expenses and Changes in Net Assets reflects a positive year with an increase in the net assets at the end of the year

During calendar year 2006, operating revenues increased 5.5%, or \$246,570, due in part to increased sales of hydro electric power. Operating expenses increased approximately 5.9% or \$222,646. This increase included a \$192,019 increase in general plant expenses, and a \$69,277 increase in production expenses.

Statement of Cash Flows

The Statement of Cash Flows presents information related to cash inflows and outflows, summarized by operating, capital and related financing activities and investing activities. Cash flows from operating activities include the sale of water, electricity and other receipts reduced by payments to suppliers and employees. Cash flows from capital and related financing activities include the purchase of capital assets. Cash flows from investing activities include interest income and the purchase and redemption of certificates of deposit. Cash flows from financing activities include proceeds and payments related to the Utility's debt.

Budget

The Utility submits a budget to the City of Ottumwa on an annual basis. Receipts for the year exceeded the amounts budgeted by \$658,051 and disbursements were less than amounts budgeted by \$2,439,292. A planned capital project was not completed as expected during the year causing the disbursements to be significantly less than the amounts budgeted.

CAPITAL ASSETS

At December 31, 2006, the Utility had \$22,600,761, invested in capital assets, net of accumulated depreciation of \$18,606,503. Depreciation and amortization charges totaled \$769,577 for the year. More detailed information about the Utility's capital assets is presented in the Notes to Financial Statements.

LONG-TERM DEBT

At December 31, 2006, the Utility had \$4,026,294 in total long-term debt outstanding. During the year ended December 31, 2006, the Utility issued a total of \$1,509,536 of water revenue bonds to finance Utility construction projects. Additional information regarding the Utility's long-term debt is included in the Notes to Financial Statements.

ECONOMIC FACTORS

Ottumwa Waters Works continued to improve its financial position during the current calendar year. However, the current condition of the economy in the State continues to be a concern for Utility officials. Some of the realities that may potentially become challenges for the Utility to meet are:

The Utilities distribution system requires constant maintenance and upkeep.

The continued inflationary increases in health care, chemical, and energy costs.

Technology continues to expand and current technology becomes outdated presenting an on-going challenge to maintain up to date technology at a reasonable cost.

The Utility anticipates the current year will be much like the last and we will maintain a close watch over resources to maintain our ability to react to unknown issues.

CONTACTING THE UTILITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, customers and creditors with a general overview of the Utility's finances and to show the Utility's accountability for the money it receives. If you have questions about this report or need additional financial information, contact Ottumwa Water Works, P.O. Box 20, Ottumwa, Iowa.

OTTUMWA WATER WORKS

STATEMENT OF NET ASSETS

DECEMBER 31, 2006

ASSETSCURRENT ASSETS:

Cash and cash equivalents	\$ 1,931,271
Certificates of deposit	830,000
Accounts receivable, net of allowance for uncollectible accounts	981,765
Inventory	134,681
Accrued interest receivable	2,885
Prepaid expenses	17,358
Total current assets	<u>3,897,960</u>

CAPITAL ASSETS:

Buildings	3,225,576
Water distribution system	27,619,443
Equipment and vehicles	1,505,996
Office equipment	571,157
Total	<u>32,922,172</u>
Less accumulated depreciation	<u>18,606,503</u>
Depreciated value of capital assets	14,315,669
Land	618,477
Construction in progress	<u>7,666,615</u>
Total capital assets	<u>22,600,761</u>

OTHER ASSETS:

Deferred charges - Debt issue costs	<u>37,256</u>
-------------------------------------	---------------

TOTAL ASSETS 26,535,977

CURRENT LIABILITIES:

Accounts payable	148,067
Accrued payroll and related expenses	29,303
Accrued interest	16,004
Sick leave	179,205
Accrued vacation	64,654
Self insurance	144,489
Accrued disability and life insurance	107,510
Customer deposits	151,887
Current maturities of long-term debt	181,000
Accrued sewer and refuse collections	<u>610,602</u>
Total current liabilities	<u>1,632,721</u>

LONG-TERM DEBT - Less current maturities3,845,294TOTAL LIABILITIES 5,478,015NET ASSETS:

Unrestricted	2,355,842
Invested in capital assets, net of related debt	18,574,467
Restricted for debt service	127,653

TOTAL NET ASSETS \$ 21,057,962

See Accompanying Notes to the Financial Statements

OTTUMWA WATER WORKSSTATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEAR ENDED DECEMBER 31, 2006OPERATING REVENUE:

Sale of water	\$ 3,486,341
Sale of electricity	967,574
Miscellaneous income	<u>272,609</u>
Total operating revenue	<u>4,726,524</u>

OPERATING EXPENSES:

Production	622,345
Distribution	638,554
Hydro	142,092
Financial services	240,873
Administration	400,254
General plant	1,162,176
Depreciation and amortization	<u>769,578</u>
Total operating expenses	<u>3,975,872</u>

OPERATING INCOME 750,652

NONOPERATING REVENUE:

Interest income	<u>164,065</u>
-----------------	----------------

CHANGE IN NET ASSETS 914,717

NET ASSETS - BEGINNING OF YEAR

20,143,245

NET ASSETS - END OF YEAR

\$ 21,057,962

OTTUMWA WATER WORKSSTATEMENT OF CASH FLOWS
YEAR ENDED DECEMBER 31, 2006CASH FLOWS FROM OPERATING ACTIVITIES:

Cash received from customers	\$ 4,412,320
Cash received from other operating receipts	272,609
Cash paid to suppliers for goods and services	(2,499,654)
Cash paid to employees for services	(1,354,122)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>831,153</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:

Purchase of capital assets	<u>(3,309,633)</u>
----------------------------	--------------------

CASH FLOWS FROM INVESTING ACTIVITIES:

Interest on investments	165,251
Redemption of certificates of deposit	850,000
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>1,015,251</u>

CASH FLOWS FROM FINANCING ACTIVITIES:

Principal proceeds on long-term debt	<u>1,509,536</u>
--------------------------------------	------------------

NET INCREASE IN CASH AND CASH EQUIVALENTS 46,307

CASH AND CASH EQUIVALENTS - Beginning of year 1,884,964

CASH AND CASH EQUIVALENTS - End of year \$ 1,931,271

RECONCILIATION OF OPERATING INCOME TO NET CASH
PROVIDED BY OPERATING ACTIVITIES:

Operating income	\$ 750,652
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	769,578
Change in operating assets and liabilities:	
Increase in accounts receivable	(41,595)
Increase in inventory	(32,893)
Increase in prepaid expenses	(15,574)
Decrease in accounts payable	(628,797)
Decrease in accrued payroll and related expenses	(10,539)
Decrease in accrued sales tax	(3,458)
Increase in accrued interest	2,489
Decrease in sick leave	(19,204)
Decrease in accrued vacation	(4,461)
Increase in self insurance	116,664
Decrease in accrued disability and life insurance	(30,405)
Increase in customer deposits	15,766
Decrease in accrued sewer and refuse collections	(37,070)
NET CASH PROVIDED BY OPERATING ACTIVITIES	\$ <u>831,153</u>

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid for interest (all capitalized)	\$ <u>104,519</u>
--	-------------------

See Accompanying Notes to the Financial Statements

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Ottumwa Water Works is organized as a municipal water utility which was established in 1910. They are overseen by a five member board appointed by the City Council and Mayor of the City of Ottumwa. The Utility's operating budget is subject to the approval of the City Council. The Water Works is considered by the City of Ottumwa to be substantially autonomous. The Water Works is funded entirely by water user charges collected from users of the Water Works' system.

The financial statements of the Water Works have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board.

Reporting Entity

For financial reporting purposes, Ottumwa Water Works has included all funds, organizations, agencies, boards, commissions and authorities. The Utility has also considered all potential component units for which it is financially accountable and other organizations for which the nature and significance of their relationship with the Utility are such that exclusion would cause the Utility's financial statements to be misleading or incomplete. The Governmental Accounting Standards Board has set forth criteria to be considered in determining financial accountability. These criteria include appointing a voting majority of an organization's governing body, and (1) the ability of the Utility to impose its will on that organization or (2) the potential for the organization to provide specific benefits to or impose specific financial burdens on the Utility. Ottumwa Water Works has no component units which meet the Governmental Accounting Standards Board criteria.

Ottumwa Water Works is not presented as a Component Unit in the City of Ottumwa's financial statements. The Utility is a legally separate entity from the City, but is financially accountable to the City. The Utility is governed by a five-member Board appointed by the City Council and the Utility's operating budget is subject to the approval of the City Council.

Basis of Presentation

The accounts of the Ottumwa Water Works are organized as an enterprise fund. Enterprise funds are used to account for operations (a) financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

Measurement Focus and Basis of Accounting

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Ottumwa Water Works applies all applicable GASB pronouncements, as well as the following pronouncements issued on or before November 30, 1989, unless these pronouncements conflict with or contradict GASB pronouncements; Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the Committee on Accounting Procedure.

The Ottumwa Water Works distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Utility's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Assets, Liabilities and Net Assets

The following accounting policies are followed in preparing the Statement of Net Assets:

Cash, Investments and Cash Equivalents – The Ottumwa Water Works considers all short-term investments that are highly liquid to be cash equivalents. Cash equivalents are readily convertible to known amounts of cash and, at the day of purchase, have a maturity date no longer than three months. Cash investments not meeting the definition of cash equivalents at December 31, 2006 include certificates of deposit of \$830,000.

Accounts Receivable – Ottumwa Water Works grants credit to customers, substantially all of whom are located in Ottumwa, Iowa. The risk of loss on the accounts receivable is the balance due at the time of default. Accounts receivable are considered past due after 30 days and are charged off when management determines the account is uncollectible. The Ottumwa Water Works uses the reserve method of accounting for uncollectible accounts. At December 31, 2006, a reserve of \$67,829 is provided to allow for uncollectible customer accounts.

Material and Chemicals Inventory – Inventories are stated at the lower of cost (determined on a first-in, first-out basis) or market.

During 1992, the Ottumwa Water Works changed its purchased material goods inventory to carry only selected groups of items and material individual items over a predetermined dollar amount. All other small parts and immaterial cost items will be expensed when purchased.

Capital Assets – Capital assets are accounted for at historical cost. Depreciation of all exhaustible capital assets is charged as an expense against operations. The cost of repair and maintenance is charged to expense, while the cost of renewals or substantial betterments is capitalized. The cost and accumulated depreciation of assets disposed of are deleted, with any gain or loss recorded in current operations.

Reportable capital assets are defined by the Utility as assets with initial, individual costs in excess of the following thresholds and estimated useful lives in excess of one year:

<u>Asset Class</u>	<u>Amount</u>
Buildings	\$ 500
Water distribution system	500
Equipment and vehicles	500
Office equipment	500

Interest is capitalized on qualified assets acquired with certain tax-exempt debt. The amount of interest to be capitalized is calculated by offsetting interest expense incurred from the date of the borrowing until completion of the project with interest earned on invested proceeds over the same period. Current year capitalized interest relates to current construction in progress projects.

Capital assets of the Utility are depreciated using the straight line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful lives (In years)</u>
Buildings	15-25
Water distribution system	40-50
Equipment and vehicles	5-7
Office equipment	5-7

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Compensated Absences – Utility employees accumulate a limited amount of earned but unused vacation hours for subsequent use or for payment upon termination, death or retirement. The Utility's liability for accrued vacation has been computed based on rates of pay in effect at December 31, 2006.

Use of Estimates - Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Accordingly, actual results could differ from those estimates.

NOTE 2 – CASH AND INVESTMENTS

The Utility's deposits in banks at December 31, 2006 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. This chapter provides for additional assessments against depositories to insure there will be no loss of public funds.

The Municipal Utility is authorized by statute to invest public funds in obligations of the United States government, its agencies and instrumentalities; certificates of deposit or other evidences of deposit at federally insured depository institutions approved by the Utility Board of Trustees; prime eligible bankers acceptances; certain high rated commercial paper; perfected repurchase agreements; certain registered open-end management investment companies; certain joint investment trusts; and warrants or improvement certificates of a drainage district.

The Utility's investments are categorized to give an indication of the level of risk assumed by the Utility at year end. The Utility's investments are all category 1, which means that the investments are insured or registered or the securities are held by the Utility or its agent in the Utility's name.

The Utility's investments at December 31, 2006 are as follows:

Certificates of deposit:	
Original maturity 6 to 12 months	\$ <u>830,000</u>

The investments are recorded at cost which approximates fair value.

NOTE 3 – CAPITAL ASSETS

A summary of capital assets at December 31, 2006 is as follows:

	Balance December 31, 2005	Additions	Deletions/ Reclassifications	Balance December 31, 2006
Capital assets, being depreciated:				
Buildings	\$ 3,221,541	\$ 4,035	\$ -	\$ 3,225,576
Water distribution system	27,482,910	136,533	-	27,619,443
Equipment and vehicles	1,466,106	39,890	-	1,505,996
Office equipment	561,249	9,908	-	571,157
Total capital assets, being depreciated	32,731,806	190,366	-	32,922,172
Less accumulated depreciation	17,838,297	768,206	-	18,606,503
Total capital assets being depreciated, net	14,893,509	(577,840)	-	14,315,669
Capital assets, net being depreciated:				
Land	618,477	-	-	618,477
Construction in progress	4,547,348	3,309,633	190,366	7,666,615
Capital assets, net	\$ <u>20,059,334</u>	\$ <u>2,731,793</u>	\$ <u>190,366</u>	\$ <u>22,600,761</u>

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 4 – PENSION AND RETIREMENT BENEFITS

The Utility contributes to the Iowa Public Employees Retirement System (IPERS) which is a cost-sharing multiple-employer defined benefit pension plan administered by the State of Iowa. IPERS provides retirement and death benefits established by state statute to plan members and beneficiaries. IPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to IPERS, P.O. Box 9117, Des Moines, Iowa, 50306-9117.

Plan members are required to contribute 3.70% of their annual covered salary and the Utility is required to contribute 5.75% of annual covered payroll for the years ended June 30, 2006, 2005 and 2004. Contribution requirements are established by state statute. The Utility's contributions to IPERS for the years ended December 31, 2006, 2005 and 2004 were \$67,794, \$67,925, and \$69,605 respectively, equal to the required contributions for each year.

NOTE 5 – SELF INSURANCE PROGRAM

The Company has a self-insurance program for hospitalization and medical coverage for its employees. The program is administered through a service agreement with Cottingham Butler. The Company limits its losses through the use of stop-loss policies from reinsurers. Specific individual losses for claims are limited to \$20,000 a year. The Company's aggregate annual loss limitation is based on a formula that considers, among other things, the total number of employees. For December 31, 2006, the Company incurred \$441,263 in expense under the program.

Amounts payable by Ottumwa Water Works at December 31, 2006 total \$144,489 which is for incurred but not reported (IBNR) and reported but not paid claims. The amounts are based on estimates of the amounts necessary to pay prior-year and current-year claims. A liability has been established based on the requirements of Governmental Accounting Standards Board Statement Number 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Settlements have not exceeded the stop-loss coverage in any of the past three years. A reconciliation of changes in the aggregate liability for claims for the current year is as follows:

Unpaid claims as of December 31, 2005	\$ 27,825
Incurred claims (including claims incurred but not reported as of December 31, 2006):	
Provision for current-year events where the Utility has retained risk of loss	441,263
Payments:	
Claims attributable to current-year events where the Utility has retained risk of loss	<u>324,599</u>
Unpaid claims as of December 31, 2006	\$ <u>144,489</u>

NOTE 6 – OTHER EMPLOYEE BENEFITS

The Water Works employees accumulate sick leave and vacation hours for subsequent use. The liability for accrued vacation at December 31, 2006 is \$64,654. The Water Works has a policy of paying one-half of the unused accumulated sick leave upon retirement of any employee. The maximum number of days an employee can accumulate is 120. Upon the death of any employee, 100% of the accumulated sick leave is paid. One-half of unused sick leave totals \$179,205, and is reflected in the financial statements as a liability at December 31, 2006.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 6 – OTHER EMPLOYEE BENEFITS (Continued)

Effective November 1, 1989, the Water Works began a long-term disability plan. Once an employee has accumulated the maximum number of days of sick leave referred to in the preceding paragraph, they begin to accumulate long-term disability days. The days are accumulated at 50% of the normal sick leave accrual rate, and the maximum number of days to be accrued is 120. The compensation is computed at 60% of the employee's normal salary and is paid only after all normal sick leave benefits are exhausted.

The amount of the accrual reflected on the balance sheet at December 31, 2006 for the long-term disability benefit is \$99,510.

NOTE 7 – POST RETIREMENT BENEFITS

On July 22, 1992, the Ottumwa Water Works approved a policy to drop the group term life insurance coverage on existing retirees and instead pay a one-time death benefit equal to the term coverage in effect as of this date. The total death benefit payable as of December 31, 2006 was \$8,000 and covers eight retirees. Only these eight retirees are covered by this provision. Any other employees retiring on or after July 22, 1992 will not receive this benefit.

NOTE 8 – DESIGNATED ASSETS

The Ottumwa Water Works has designated assets comprised of demand deposits, passbook savings, and certificates of deposits that are to be used for a specific purpose. A summary of the designated assets is as follows:

Capital Improvements and Extension Projects Fund – This fund is designated for use in completing capital improvements as set forth in the March 5, 1991 Stanley Consultants' Ottumwa Water Works Distribution System Analysis as approved by the Board of Trustees on November 22, 1994. The amount designated for the capital improvements fund as of December 31, 2006 is \$328,100.

Meter Deposit Fund – This fund is used to account for cash collected on customer deposits. The amount designated for the meter deposit fund as of December 31, 2006 is \$149,306.

NOTE 9 – RESTRICTED FOR DEBT SERVICE

Restricted net assets are available for the following purpose for the year ended December 31, 2006:

Water revenue bond sinking fund	\$ <u>127,653</u>
---------------------------------	-------------------

NOTE 10 – RELATED PARTY TRANSACTIONS

The Water Works provides billing and collection services to the City of Ottumwa for sewer and refuse services. The following is a summary of the balances due to the City at December 31, 2006:

Accrued sewer services charges	\$ 446,488
Accrued refuse collection fees	<u>164,114</u>
Total accrued sewer and refuse collections	\$ <u>610,602</u>

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 11 – LONG-TERM DEBT

A summary of the changes in long-term liabilities for the year ended December 31, 2006, is as follows:

	Balance Beginning Of Year	Increases	Decreases	Balance End Of Year	Due Within One Year
Revenue Bonds	\$ <u>2,516,758</u>	\$ <u>1,509,536</u>	\$ <u>-</u>	\$ <u>4,026,294</u>	\$ <u>181,000</u>

Annual debt service requirements to maturity for revenue bonds are as follows:

Maturing Year Ending December 31, Fully Matured	Interest Rate Various	Outstanding Amount \$ <u>32,000</u>	Interest \$ <u>7,140</u>
---	--------------------------	---	-----------------------------

The resolutions providing for the issuance of the above revenue bonds include the following provisions:

- (a) The bonds will only be redeemed from the future earnings of the enterprise activity and the bond holders hold a lien on the future earnings of the funds.
- (b) Sufficient monthly cash transfers shall be made to a water revenue bond sinking account for the purpose of making bond principal and interest payments when due.
- (c) Additional monthly cash transfers shall be made to a bond and interest reserve account until there has been accumulated an amount equal to two years' interest on the bonds then outstanding. This account is restricted for the purpose of paying bond principal and interest should funds be insufficient in the water revenue bond sinking account.
- (d) In addition, there shall be deposited to a capital improvement and extension account the sum of \$3,000 each month until there has been accumulated a sum of \$500,000. This account shall be used solely and only to pay bonds and interest should deficiencies exist in the water revenue bond sinking account or the bond and interest reserve account to pay subordinate revenue bonds issued to make necessary improvements and extensions to pay for capital improvements and extensions to the existing Water Works' plan not covered by issuance of bonds and to call and redeem such bonds as they may be then subject to redemption prior to maturity.
- (e) There shall also be paid into a bond redemption account on a monthly basis one-half of the balance of net earnings remaining after first making the required payments into the water revenue bond sinking account, the bond and interest reserve account and the capital improvement and extension account. This account is restricted to remedying any deficiency in the other required accounts. The Water Works reserves, in the aforementioned accounts, exceed the outstanding bond and interest amounts and therefore, this provision does not apply.

On June 2, 2005, the Utility entered into agreements with the Iowa Department of Natural Resources and Wells Fargo Bank Iowa, N.A. for the issuance of \$4,000,000 of water revenue bonds, with an interest rate of 3.0% per annum. The bonds were issued pursuant to the provisions of Chapter 384 and Section 384.24A of the Code of Iowa to pay the costs of constructing improvements and extensions to the water system.

OTTUMWA WATER WORKS

NOTES TO FINANCIAL STATEMENTS

NOTE 11 – LONG-TERM DEBT (Continued)

At December 31, 2006, the Utility had drawn \$3,994,294, including initiation fees of \$40,000. Wells Fargo Bank Iowa, N.A. has the remaining balances of each issue held in trust, which the Utility will request as the projects progress. Expected repayment schedules are as follows:

<u>Year Ended</u> <u>December 31,</u>	
2007	\$ 149,000
2008	153,000
2009	158,000
2010	163,000
2011	167,000
2012 and after	<u>3,204,294</u>
	\$ <u>3,994,294</u>

NOTE 12 – RISK MANAGEMENT

The Utility is exposed to various risks of loss related to torts; theft, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by the purchase of commercial insurance. Settled claims from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. The Utility assumes liability for any deductibles and claims in excess of coverage limitations.

NOTE 13 – MAJOR CUSTOMERS

Sales to three major customers accounted for greater than 50% of total sales for the year ended December 31, 2006. At December 31, 2006, amounts due from these customers were \$229,305.

NOTE 14 – COMMITMENTS AND CONTINGENCIES

The Utility has signed various contracts for current construction projects as well as a future sewer project in conjunction with the City of Ottumwa, Iowa. Amounts on those contracts will be paid as progress on the projects occurs.

REQUIRED SUPPLEMENTARY INFORMATION

OTTUMWA WATER WORKS

BUDGETARY COMPARISON SCHEDULE OF
RECEIPTS, DISBURSEMENTS AND CHANGES IN
BALANCES - BUDGET AND ACTUAL
YEAR ENDED DECEMBER 31, 2006

	<u>Actual</u>	<u>Adjustments</u>	<u>Net</u>	<u>Budget</u>	<u>Variance Favorable (Unfavorable)</u>
Receipts:					
Use of money and property	\$ 164,065	\$ -	\$ 164,065	\$ 90,000	\$ 74,065
Charges for service	<u>4,726,524</u>	<u>-</u>	<u>4,726,524</u>	<u>4,142,538</u>	<u>583,986</u>
	<u>4,890,589</u>	<u>-</u>	<u>4,890,589</u>	<u>4,232,538</u>	<u>658,051</u>
Disbursements:					
Business-type activities	3,975,872	(769,578)	3,206,294	3,313,920	107,626
Capital projects/debt service	<u>-</u>	<u>3,309,633</u>	<u>3,309,633</u>	<u>5,641,300</u>	<u>2,331,667</u>
	<u>3,975,872</u>	<u>2,540,055</u>	<u>6,515,927</u>	<u>8,955,220</u>	<u>2,439,293</u>
Excess (deficiency) of receipts over (under) disbursements	914,717	(2,540,055)	(1,625,338)	(4,722,682)	3,097,344
Other financing sources, net	<u>-</u>	<u>1,509,536</u>	<u>1,509,536</u>	<u>6,100,000</u>	<u>(4,590,464)</u>
Excess (deficiency) of receipts and other financing sources over (under) disbursements	\$ <u>914,717</u>	\$ <u>(1,030,519)</u>	\$ <u>(115,802)</u>	\$ <u>1,377,318</u>	\$ <u>(1,493,120)</u>

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION - BUDGETARY REPORTING

YEAR ENDED DECEMBER 31, 2006

The budgetary comparison is presented as Required Supplementary information in accordance with Government Accounting Standards Board Statement No 41 for governments with significant budgetary perspective differences

In accordance with the Code of Iowa, the Utility annually adopts a budget on the modified accrual basis following required public notice and hearing for all funds. The annual budget may be amended during the year utilizing similar statutorily prescribed procedures.

Formal and legal budgetary control is based upon ten major classes of expenses known as functions, not by fund. These ten functions are: public safety, public works, health and social services, culture and recreation, community and economic development, general government; debt service, capital projects, business-type activities and non-program. Although the budget document presents function expenses by fund, the legal level of control is at the aggregated function level, not by fund. During the year, there were no budget amendments.

OTHER SUPPLEMENTARY INFORMATION

OTTUMWA WATER WORKS

DETAIL SCHEDULE OF REVENUES AND EXPENSES
YEAR ENDED DECEMBER 31, 2006

OPERATING REVENUE:

Sale of water	\$ 3,486,341
Sale of electricity	967,574
Miscellaneous income:	
Fire protection - Private	92,637
Customer forfeitures	25,492
Service connections	36,976
Service charge - Sewer billing	45,431
Service charge - Refuse billing	23,808
Miscellaneous	48,265
TOTAL OPERATING REVENUE	<u>4,726,524</u>

OPERATING EXPENSES:

Production:	
Supervision	42,756
Maintenance labor	76,564
Operations labor	184,205
Chemicals/carbon	308,637
Laboratory supplies	10,183
	<u>622,345</u>
Distribution:	
Supervision	46,293
Maintenance labor	206,951
Maintenance materials	143,069
Labor	117,085
Contract street repairs	125,156
	<u>638,554</u>
Hydro:	
Supervision	13,950
Maintenance labor	33
Operations labor	70,559
Supplies	37,399
Lease and rentals	17,951
Contract labor	2,200
	<u>142,092</u>
Financial services:	
Financial services supervision	49,421
Financial services labor	99,457
Office supplies	23,520
Postage expense	50,305
Customer deposit accounts interest	4,837
Noncollectable accounts	13,333
	<u>240,873</u>

OTTUMWA WATER WORKS

DETAIL SCHEDULE OF REVENUES AND EXPENSES
YEAR ENDED DECEMBER 31, 2006

OPERATING EXPENSES: (Continued)

Administration:

Executive salaries	\$ 65,328
Board salaries	1,400
Training expense	4,761
Vacation pay	67,728
Holiday expense	44,714
Longevity expense	16,228
Casual pay	21,872
Sick pay	29,661
Disability	(29,405)
Payroll tax - FICA	91,157
IPERS	67,794
Subscriptions	530
Legal services	8,108
Business expense	<u>10,378</u>
	400,254

General plant:

Employee's miscellaneous expense	11,986
General property expense	66,370
Safety program	15,907
Liability insurance	52,884
Workmen's compensation insurance	21,454
Group health insurance	564,886
Group term life insurance	3,105
Contract labor	44,849
Fuel and power	290,126
General services	49,874
Contingency	6,907
Gas and oil	33,620
Lease and rental	<u>208</u>
	1,162,176

Depreciation and amortization	<u>769,578</u>
-------------------------------	----------------

TOTAL OPERATING EXPENSES	<u>3,975,872</u>
--------------------------	------------------

OPERATING INCOME	750,652
------------------	---------

NONOPERATING REVENUE:

Interest income	<u>164,065</u>
-----------------	----------------

CHANGE IN NET ASSETS	\$ <u>914,717</u>
----------------------	-------------------

INDEPENDENT AUDITOR'S REPORT ON INTERNAL
CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE
AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Board of Trustees
Ottumwa Water Works
Ottumwa, Iowa

We have audited the accompanying financial statements of Ottumwa Water Works, as of and for the year ended December 31, 2006, and have issued our report thereon dated August 16, 2007. We conducted our audit in accordance with U.S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Ottumwa Water Works' internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our opinion on the effectiveness of Ottumwa Water Works' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of Ottumwa Water Works' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and material weaknesses.

A control deficiency exists when the design or operation of the control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects Ottumwa Water Works' ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood a misstatement of Ottumwa Water Works' financial statements that is more than inconsequential will not be prevented or detected by Ottumwa Water Works' internal control. We consider the deficiencies in internal control described in the accompanying Schedule of Findings to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood a material misstatement of the financial statements will not be prevented or detected by Ottumwa Water Works' internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we believe item I-A-06 is a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Utility's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, non-compliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of non-compliance or other matters required to be reported under Government Auditing Standards.

Comments involving statutory and other legal matters about the Utility's operations for the year ended December 31, 2006 are based exclusively on knowledge obtained from procedures performed during our audit of the financial statements of the Utility. Since our audit was based on tests and samples, not all transactions that might have had an impact on the comments were necessarily audited. The comments involving statutory and other legal matters are not intended to constitute legal interpretations of those statutes.

Ottumwa Water Works' responses to findings identified in our audit are described in the accompanying Schedule of Findings. While we have expressed our conclusions on the Utility's responses, we did not audit Ottumwa Water Works' responses and, accordingly, we express no opinion on them.

This report, a public record by law, is intended solely for the information and use of the officials and customers of the Utility and other parties to whom the Utility may report. This report is not intended to be and should not be used by anyone other than these specified parties.

We would like to acknowledge the many courtesies and assistance extended to us by personnel of Ottumwa Water Works during the course of our audit. Should you have any questions concerning any of the above matters, we shall be pleased to discuss them with you at your convenience.

ANDERSON, LARKIN & CO. P C

Ottumwa, Iowa
August 16, 2007

OTTUMWA WATER WORKS
SCHEDULE OF FINDINGS
YEAR ENDED DECEMBER 31, 2006

Part I: Findings Related to the Financial Statements

SIGNIFICANT DEFICIENCIES:

- I-A-06 Segregation of Duties - An important aspect of internal control is the segregation of duties among employees to prevent an individual employee from handling duties which are incompatible.

Recommendation - We realize that with a limited number of office employees, segregation of duties is difficult. However, the Utility should review its control procedures to obtain the maximum internal control possible under the circumstances.

Response - We will continue to institute segregation and rotation of employee's duties wherever possible in relation to our staff size

Conclusion - Response accepted.

Instances of Non-Compliance:

No matters were reported.

Part II: Other Findings Related to Statutory Reporting

- II-A-06 Certified Budget - Ottumwa Water Works' expenses during the year ended December 31, 2006 did not exceed the amount budgeted.
- II-B-06 Questionable Expenses - No expenses we believe may not meet the requirements of public purpose as defined in an Attorney General's opinion dated April 25, 1979 were noted.
- II-C-06 Travel Expense - No expenditures of money for travel expenses of spouses of Utility officials or employees were noted.
- II-D-06 Business Transactions - No business transactions between the Utility and Utility officials or employees were noted.
- II-E-06 Bond Coverage - Surety bond coverage of Utility officials and employees is in accordance with statutory provisions. The amount of coverage should be reviewed annually to insure that the coverage is adequate for current operations.
- II-F-06 Trustee Minutes - No transactions were found that we believe should have been approved in the minutes but were not
- II-G-06 Revenue Bonds - The Water Works has complied with the revenue bond provisions for the year ended December 31, 2006.
- II-H-06 Deposits and Investments - No instances of noncompliance with the deposit and investment provisions of Chapter 12B and 12C of the Code of Iowa were noted